Testimony of California State Senator Alan Lowenthal
May 24, 2007

Mr. Chairman and Members:

Thank you for inviting me here today to discuss California's experience with public-private partnerships and to share my thoughts concerning a direction that a policy on PPPs might take.

When it comes to transportation funding, California is in the midst of the same struggle as is the federal government: California has not raised its gas tax since 1994, and the value of the tax has eroded substantially due to inflation and rising construction costs. At the same time, the state expects tremendous population growth, with the number of vehicle miles traveled growing at an even faster rate. People are driving increasingly more, placing greater demands on our transportation system. As a result, the state has been in the uncomfortable position of under-investing in its transportation infrastructure. And today we have some of the worst congestion in the nation.

PPPs have been increasingly presented to policy makers as a "tool" to finance much needed transportation facilities. In California, the debate has focused solely on using PPPs for greenfield development, that is, a situation whereby a public agency enters into a long-term concession or lease agreement with a private entity for the design, build, finance, and operation of a new transportation facility. As a state, we are not considering the "sale" of existing assets such as the Golden Gate Bridge.

California's Experience with PPPs

PPPs are not new to California. In 1989, the Legislature passed legislation that authorized the state Department of Transportation, referred to as Caltrans, to enter into contractual agreements with private entities for the construction and operation of four privately financed toll roads. The first project developed under this authority was the SR 91 Express Lanes, which consisted of toll lanes in the median of an existing state highway. The California Private Transportation Company (CPTC) entered into a franchise lease agreement with Caltrans to construct and operate the toll lanes, which were constructed for $139 million and opened in 1995.

The SR 91 toll lanes generated substantial controversy. A clause in the lease agreement between Caltrans and CPTC prohibited the department from granting similar franchise rights to third parties or developing any public transportation facility within an "Absolute Protection Zone." This restriction, commonly referred to as the "non-compete clause," was deemed necessary to protect the toll road's profitability and CPTC's investment. Caltrans proposed to make a number of "safety" improvements totaling $30.6 million, in order to curb the growing number of congestion-related accidents, but after CPTC sued, Caltrans settled and the improvements were not made. Congestion on SR 91 continued to worsen. In 2002, legislation was passed that allowed the Orange County Transportation Authority (OCTA), a public agency, to purchase the franchise rights to the toll lanes from CPTC, effectively repealing the non-compete clause and facilitating improvements along the corridor. OCTA acquired the SR 91 toll lanes for $207.5 million, making California's first operational private toll project a public facility.

California's second and only other PPP is State Route 125. This project was begun in 1991, but the project approval process proved to be lengthy, and final environmental clearance was not granted until 2001. In 2003, the project received financing from Macquarie Infrastructure Group and construction began. The 12 ½-mile project has experienced significant cost overruns and project delays. Who bears responsibility for these increased costs – the public or the private partner - is subject to dispute between the two parties. To facilitate the resolution of this dispute, the state legislature passed legislation to extend CTV's lease agreement and the period of time that tolls may be charged for use of the facility. This facility is not yet in service, and already the authority to charge motorists tolls has been extended.

Costs versus Benefits

California's experience with PPPs lends support to the following concerns about these arrangements:

- Concession agreements may limit the ability of a public agency to adapt to the changing transportation needs of a region. For example, non-compete clauses and clauses which require a public agency to pay "just compensation" to a private entity for the development of a nearby, competing facility constrains the ability of the public agency to make improvements to the area's transportation system and increases the cost of those projects for the public agency.

- Working with a private entity may be a contentious, potentially litigious endeavor for public agencies because private companies may work to protect their investment over the public interest.

While PPPs have a troubled history in California, the state recognizes that an important advantage of development concessions may be that, because private companies use their own capital to finance the construction of a facility, state and local agencies may be able to build a larger number of projects and/or projects that are larger in scope. For this reason, I offer the following thoughts as a potential way forward on this issue.

A Way Forward: PPPs in Goods Movement

One arena in transportation that might be ripe for public-private partnerships is goods movement. Last year, the California Legislature passed legislation to authorize four PPPs in the realm of goods movement. The state's infrastructure can barely handle existing trade activity, let alone accommodate the coming growth. Forty-five percent of the nation's seaborne cargo enters the state via the Ports of Los Angeles and Long Beach, the majority of which is simply passed through our state to other parts of the country, and the level of trade is expected to double by 2020. Southern California is experiencing a public health crisis due to poor air quality associated with goods movement-related emissions. And, the federal government is nowhere in sight.

Under the current system of transportation funding, retailers and manufacturers profit from using California's transportation infrastructure. Public-private partnerships could provide needed goods movement-related facilities. Examples of projects include truck-only toll lanes, toll bridges, and rail projects, among other types of facilities.

The primary users and beneficiaries of these facilities would be private entities such as retailers and manufacturers, and the trucking companies or railroads employed to move their cargo. Limiting PPPs to goods movement, where a private company (concessionaire) charges other private companies (retailers, manufacturers, trucking companies) for the use of the facility, evens the "playing field" so to speak between those who control the facility and those who pay to use it. Cargo owners have a greater ability to pay for their use of the facility and/or pass on their costs and they have a greater ability to choose different facilities (e.g., other ports) if the price of doing business using that facility becomes too high.

In short, I believe one direction a policy on PPPs may take is to encourage their use for the development of goods movement-related infrastructure projects to demonstrate their actual potential and their actual risks.

Since passing legislation authorizing PPPs for this purpose, we have heard concerns that the authority is not broad enough or creates obstacles that are two difficult to overcome. Rather than suggesting amendments to the current policy for PPPs in goods movement, advocates for PPPs have sought to expand the authority to include all types of transportation projects. Before the state will consider a broader policy, the following questions must be addressed:

- Assuming the authority to impose tolls or user fees exists, what legal and financial obstacles preclude a public agency from developing a toll facility and achieving the same benefits as a PPP? What is the advantage of involving the private sector in finance?

- What is the proper assignment of risk in these transactions? How much risk should the public sector bear versus that which the private sector bears?

- Do facilities developed by a private company, which has a duty to provide a reasonable rate of return to its investors, ultimately cost the public (i.e., the users) more if it were developed by a private company than if it were developed by a public agency, which has no such duty?

- To what extent would the capacity of a project to generate revenue dictate which transportation projects were developed and which were not, potentially leading to a fragmented transportation system that may not, over time, meet the needs of the state as a whole?

Before I close, I would also like to suggest that there are a series of intermediate steps that states may take to address infrastructure dilemmas and to take advantage of private sector benefits such as innovation and efficiency. First, states could develop more publicly-operated toll facilities, which also invite private capital into the mix through the sale of tax-exempt bonds. States could allow a greater role for the private sector in the operation of facilities. Finally, regardless of whether a facility is public or private, both the federal government and states should do more to encourage demand management strategies in order to achieve higher performance from our existing facilities.

Thank you very much for your time. I am happy to answer any questions you may have.